PROPERTY INSIGHTS

Kuala Lumpur | Quarter 2, 2016

Subdued economic growth dampen investment sentiments

Market Overview

- Malaysia's economy grew at a slower pace in Q1 2016 due to slower growth in manufacturing and service sectors. Labour market conditions were also subdued as the manufacturing sector experienced more retrenchment.
- Concerns over an oversupply of office space and subdued oil and gas sectors continued to place downward pressure on rents and occupancies. However, the delay of completion of some of the projects in the pipeline helped moderate the decline in rents and occupancies.
- Retail sales fell by 4.4% q-o-q in Q1 2016, compared to a 4.6% growth a year ago. Recently opened malls faced difficulties securing tenants, as their opening occupancy rates were about 60%.
- Prices for high end condominiums declined by 1.7% q-o-q to RM740 per sq ft, although rents for high end condominiums largely remained the same.

Trends & Updates

The Economy

Key Highlights in Q2

- The Malaysian economy grew 4.2 per cent on a y-o-y basis in Q2 (Q4 2015: 4.5% y-o-y) (Figure 1).
- Unemployment rate increased to 3.4% in Q1 2016 from 3.2% in Q4 2015.
- Private final consumption expenditure strengthened to 5.3 per cent (Q4 2015:4.9%).
- Consumer Price Index (CPI) rose by 3.4% y-o-y in Q1, higher than 2.6% increase in Q4 2015.
- Consumers Sentiment Index rose to 72.9 in Q1 from 63.8 in Q4 2015. (Figure 2)
- Ringgit depreciated against US dollar by 4.3% in Q2 to RM4.03 to USD 1 (Figure 3).

Market Commentary

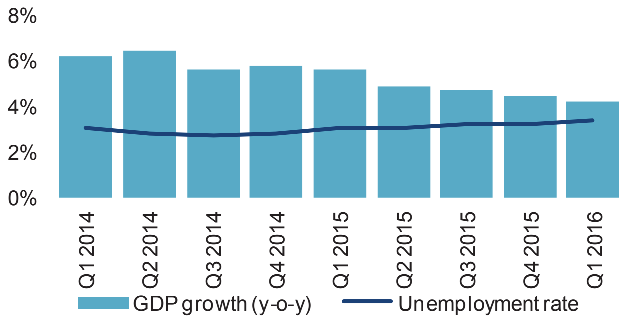
Malaysia's economy grew at a slower pace in Q1 2016 due to slower growth in the manufacturing and service sectors. Additionally, slower domestic demand and contraction in net exports further dragged Malaysia's economic growth. Labour market conditions were also subdued, as the manufacturing sector experienced more retrenchment.

For instance, Intel Malaysia plans to cut about 10% of the 13,500 workers in both Penang and Kulim manufacturing plants, in line with Intel US' announcement on plans to reduce its global workforce by 11% of its entire workforce of about 107,000. Megasteel Sdn Bhd (subsidiary of Lion Group) issued 200 factory workers a 24-hour notice of termination on April 1, 2016. In March 2016, British American Tobacco (BAT) announced the closure of its manufacturing plant, affecting 230 employees.

Notwithstanding, the expansion in private and government final consumption helped offset the sluggish performance in external demand. The Consumer Sentiments Index (CSI) increased to 72.9 in Q1 2016 from 63.8 in Q4 2015. However, the improvement in consumption is likely to be transient with the increase in costs of living following the reduction in electricity tariff rebates in January 2016. The subsidy cuts raised the costs for housing, water, electricity, gas and other fuels.

Figure 1

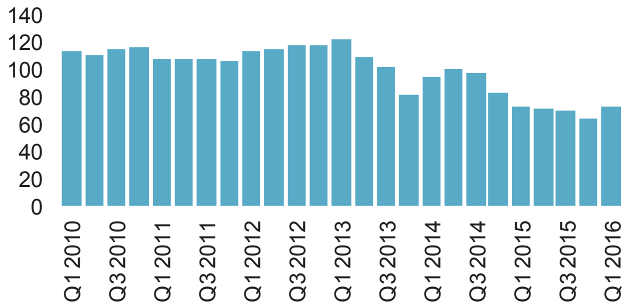
GDP Growth and Unemployment



Source :Bank Negara Malaysia, Department of Statistics Malaysia, NTL Research

Figure 2

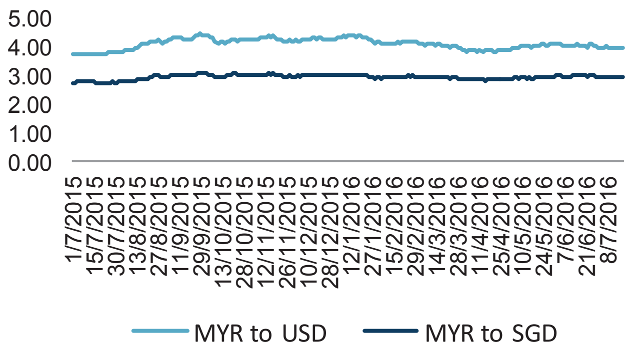
Consumer Sentiments Index



Source : Malaysian Institute of Economic Research, NTL Research

Figure 3

Malaysia Ringgit Exchange Rate



Source : Malaysian Institute of Economic Research, NTL Research

Outlook

It is expected that private consumption will slow down as a result of softer labour markets and cautious household spending triggered by new GST and subsidy cuts. Additionally, the outflow of foreign capital is expected to weaken the Ringgit, and consumers' sentiments. According to Malaysian Industrial Development Finance Berhad, the Malaysian equity market recorded net outflow of foreign funds for seven consecutive weeks in Q2 2016. Notwithstanding, the recent appreciation in oil prices helped cushioned the fall in Ringgit and the government's move to maintain a competitive monetary policy and lending rates will help support economic growth.

Residential

Key Highlights in Q2

- Only one residential development was completed in the city centre in Q2, adding 441 high-end condominium units into the market.
- 7,183 units of high-end condominiums are expected to enter the market by year end, with 58% of new supply outside city centre (Figure 4)
- Prices for high-end condominiums declined by 1.7% q-o-q to RM740 per sq ft (Figure 5)
- Rents for high-end condominiums largely remained unchanged q-o-q at RM 3.20 per sq ft per month.

Market Commentary

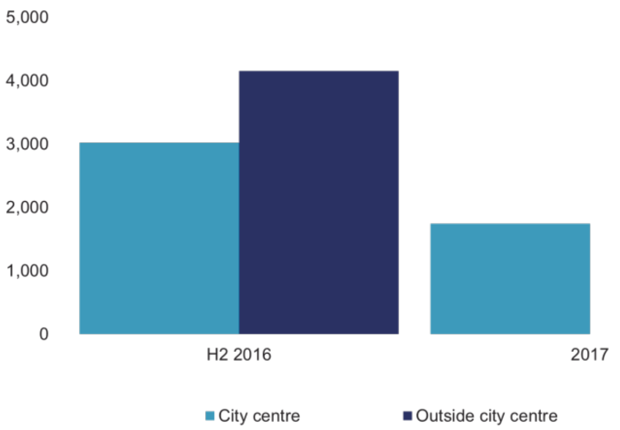
Tighter lending facilities and cautious sentiments impacted on sales volume and value of residential transactions, which dropped in last 4 quarters. Sales and new launches continued to be relatively slow, although the take-up rate tends to be location and project-specific. Projects sited in the city centre and close to infrastructure developments are more likely to benefit from stronger demand.

Outlook

Buying sentiments are likely to remain weak due to external events, although choice projects are likely to remain popular. With Malaysia's central bank cutting its key interest rate by 25 basis points to 3.00 percent, borrowing costs are lowered and that may encourage more home purchases.

Figure 4

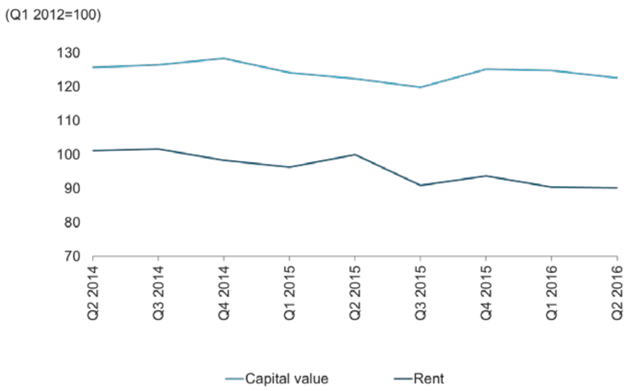
Future supply of high-end condominiums in Kuala Lumpur



Source: NTL Research

Figure 5

Rental and price indices of high-end condominiums in Kuala Lumpur



Source: NTL Research

Retail

Key Highlights in Q2

- Retail sales fell by 4.4% q-o-q in Q1 2016, compared to a 4.6% growth a year ago.
- Malaysia Retail Association (MRA) also forecasted a 9.9% q-o-q growth in sales for Q2 2016, followed by 5.0% and 5.5% growth rates for Q3 and Q4 2016.
- Total retail stock in Kuala Lumpur increased to 27.23m sq ft (Figure 6). Total retail stock outside Kuala Lumpur stayed the same at 29.15 m sq ft.
- Occupancy rate of retail malls in Kuala Lumpur crept up to 90.3% from 89.9% in Q1.
- For malls that opened recently, their opening occupancy rates were about 60%.
- More overseas retailers establishing their presence in Malaysia

Market Commentary

While consumer sentiments in Q1, it was still below the threshold level of confidence. Most Malaysians remained cautious in spending, especially big-ticket items such as cars. Perodua announced that its sales dropped 17.4% y-o-y in Q1 2016.

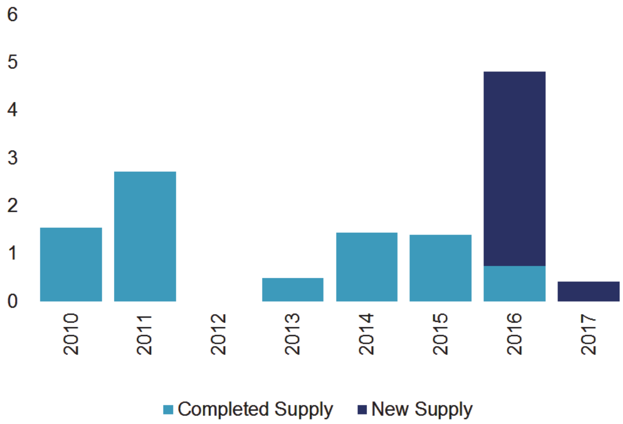
The Malaysian retail industry also recorded a fall in sales according to MRA. As prices of retail goods and services continued to rise due to the weak ringgit, the spending power of Malaysian consumers further deteriorated. The department store cum Supermarket subsector suffered the worst performance according to the retailers' association. New completions in Q2 further compounded the challenges to the retailers. In Kuala Lumpur, Glo Damansara (360,000 sq ft) and Giant Setapak (88,254 sq ft) were completed.

Despite the challenges faced by the retail sector, the occupancy rate for retail malls in Kuala Lumpur rose as existing malls saw an increase in take up. There were more overseas retailers coming into the market. For instance, Japan's Family Mart plans to open its first store in Kuala Lumpur by the end of the year and open 300 stores in the country within 5 years. Family Mart Co Ltd is the second largest convenience store chain in the world after 7-Eleven. Another case-in-point was Middle Eastern retailer, LuLu Group International, who opened its first store within Jakel Square in Kuala Lumpur and occupy 250,000 sq ft

Nevertheless, new malls faced difficulties securing the tenants. For instance, the occupancy rates for M3 mall in Kuala Lumpur and Damen USJ were 60% and Glo Damansara was at 40%.

Figure 6

Retail new supply (NLA) in Kuala Lumpur, sq ft (million)



Source: NTL Research

Table 1

Selected upcoming retail malls in Klang Valley

Name of development	Est Area (NLA, sq ft)	Est year of completion
Empire City	1,500,000	2016
MyTown	1,100,000	2016
The Two	1,350,000	2017
KSL City Mall 2	2,200,000	2017
Tropicana Gardens Mall	1,000,000	2018

Source: NTL Research

Outlook

With more malls coming on board in 2016 and 2017, we anticipate retailers to face greater competition (Table 1). Retailers will have to offer greater discounts to increase sales volume, which will further erode their profits.

Office

Key Highlights in Q2

- No new office completion in Q2, total stock maintained at 77.5m sq ft.
- Occupancy rate for Kuala Lumpur office was at 79.4% (Q1 2016: 79.2%) (Figure 7).
- Average office rents in central areas declined to RM 6.03 per sq ft to RM6.12 per sq ft.
- Capital value and average yield for office space maintained at RM 933 per sq ft and 6.25%.

Market Commentary

Concerns over an oversupply of offices space and subdued oil and gas sector continued to place downward pressure on prime office rents and occupancies. As a result, new completions have slowed. In Q2, there were no completions after the influx of supply in Q1. The lack of new completions helped support office occupancy rates (Figure 8).

Given the softer office market, average rents in central areas also eased as landlords offered more competitive rents to retain their tenants and attract new prospects. Rents of office space in fringe areas, however, stayed at RM 4.25 per sq ft, as there was some demand from firms who were open to relocate outside the central business district.

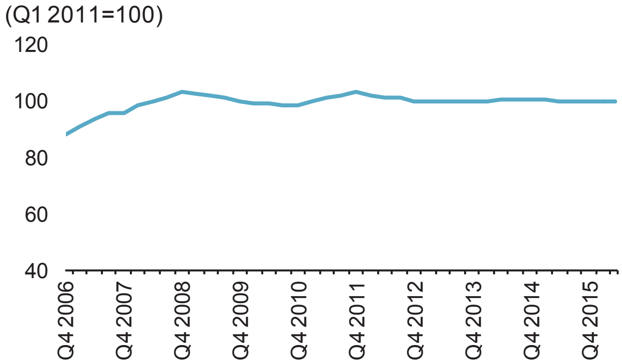
Capital values for office space largely remained unchanged amid a slower market. There was only one office transaction in Q2, with some 93,800 sq ft of office space transacted at Cyberjaya.

Outlook

Given that about 2.6 m sq ft of new supply is slated for 2H 2016 (Figure 9), which include Bangsar Trade Centre (NLA:112,000 sq ft), JKG Tower (NLA: 397,000 sq ft) and Public Mutual Tower (NLA: 400,000 sq ft), there are concerns of an oversupply. Some projects have postponed their completion dates as a result. For instance, Menara Ken (NLA:215,000 sq ft) in TTDI was pushed to Q4 2016 and the Vertical (NLA 1.5m sq ft) in Bangar South is also pushed to 2H 2016.

Figure 7

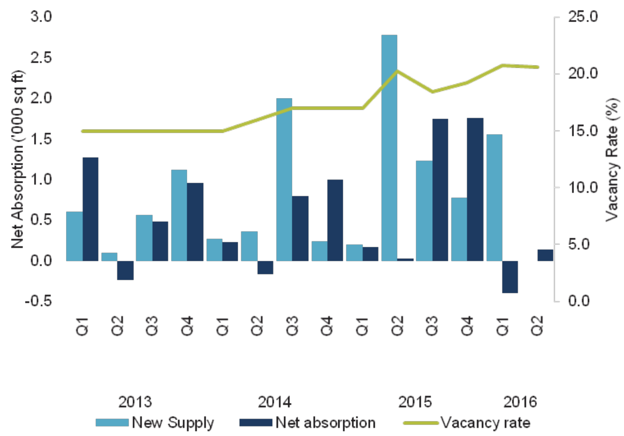
Prime rental indices



Source: NTL Research

Figure 8

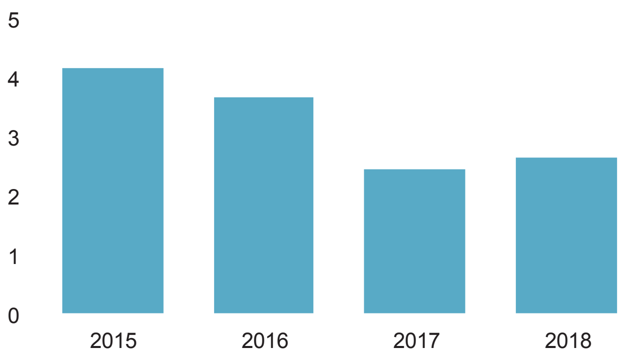
Office net absorption, sq ft (million)



Source: NTL Research

Figure 9

Future vacant space as at Q2 2016



Source: NTL Research

In light of the mismatch of supply and demand across sectors, the Deputy Minister of the Ministry of Federal Territories announced that no new office building applications in Kuala Lumpur will be approved by the ministry. Notwithstanding, approval may still be given to applications submitted earlier, development plans that are currently in the works or construction of corporate buildings for businesses' own use.

While weaker business sentiments, especially from oil and gas and financial services sectors, will dampen office demand, the delay of new completions will help keep rent levels and occupancy rates stable.

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